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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

KRYGOSKI CONSTRUCTION COMPANY, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

SUPPLEMENTAL BRIEF OF THE PETITIONER IN SUPPORT OF ITS PETITION FOR WRIT OF CERTIORARI

WILSIE H. ADAMS, JR. *
PATRICK K. O'KEEFE
KURT J. HAMROCK
MCKENNA & CUNEO, L.L.P.
1900 K Street, N.W.
Washington, D.C. 20006
(202) 496-7500

Counsel for Petitioner
**Counsel of Record*

PRESS OF BYRON S. ADAMS ◆ WASHINGTON, D.C. ◆ 1-800-347-8208

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RULE 29.6 STATEMENT

Petitioner Krygoski Construction Company has no parent corporation and has no nonwholly owned subsidiaries.

Petitioner Krygoski Construction Company ("Krygoski") submits the following supplemental brief in support of its pending petition for a writ of certiorari. The rules of this Court permit the filing of such a supplemental brief to "call[ ] attention to new cases, new legislation, or *other intervening matter not available at the time of the party's last filing.*" S. Ct. R. 15.8 (emphasis added).

The purpose of this brief is to call the Court's attention to recent analysis and criticism of the Federal Circuit's decision. The April 14, 1997 issue of the *Federal Contracts Report* contains an in-depth review of the lower court's opinion written by two experienced government contract practitioners. This issue was received by counsel for petitioner on April 16, 1997, after the filing of petitioner's reply brief. A copy of the review is attached hereto as an appendix.

The analysis echoes and supports a number of the points raised in the petition and Krygoski's reply brief. First, it recognizes the confusion that surrounds the proper application of the "changed circumstances" doctrine described in *Torncello v. United States*, 681 F.2d 756 (Ct. Cl. 1982) (*en banc*). *See* App. 6h ("For the most part, the courts and boards of contract appeals have struggled with the proper scope and application of the holding in *Torncello* . . . .").

Closely reviewing the plurality and concurring opinions in *Torncello*, the analysis recognizes that a majority of the Court of Claims adopted the changed circumstances test "in some form." *See* App. 22h. As an *en banc* decision, the *Torncello* holding cannot be overruled by a panel of the Federal Circuit. App. 15h.

Second, the review recognizes that the panel decision below raises a serious concern as to the absence of consideration in, and the consequent unenforceability of, government contracts containing a termination for convenience clause. *See* App. 21h ("Does *Krygoski* leave us with any meaningful limits on the government's rights to

terminate for convenience? Apparently not.") The only theoretical limit that remains to the government's power to terminate—namely, that it cannot act in bad faith or abuse its discretion—is "so remote, a contractor could not realistically expect to prove it had been transgressed." *See* App. 21h.

The analysis also criticizes the Federal Circuit's "novel" reliance on the Competition in Contracting Act of 1984, Pub. L. No. 98-369, tit. VII, § 303A, 98 Stat. 1175, 1178 ("CICA"). The authors confirm that, since the passage of CICA in 1984, no other decision has linked CICA with the resolution of the *Torncello* issue. App. 16h. They point out that "neither the phrase 'termination for convenience,' nor the concept of a unilateral right to walk away from an agreement at minimal cost, appears anywhere in CICA." App. 17h. Finally, they note that the "legal innovations which *Krygoski* attributes to CICA are not really new at all. Without exception, CICA simply did not alter the law in the ways the opinion suggests." *Id.*

With respect to the *Krygoski* panel's invocation of the "cardinal change" doctrine, the analysis notes that the panel properly described the law of cardinal changes. However, the analysis goes on to criticize the Federal Circuit's application of the cardinal change doctrine under the facts of the case as found by the trial court. Because a significant amount of asbestos was expected to be uncovered by the parties to the contract, "the presence of additional asbestos should have surprised no one." App. 20h. The mere change in the amount of asbestos to be removed is not the sort of contract modification that "goes beyond the scope of the original competition." *See* App. 19h. To suggest that such expected changes are beyond the scope of the original contract "is a hard pill for practitioners to swallow." *See* App. 20h.

Finally, the analysis recognizes that an unlimited right of the government to terminate a contract through the use of a termination clause is contrary to "the current trend to 'commercialize' government procurement." *See*

App. 25h. The analysis recommends a return to the changed circumstances test of *Torncello* as "a better starting point" than the "cardinal change" standard of the Federal Circuit's opinion below. *See* App. 23h.

The conclusions of the authors clearly support granting the petition for certiorari in this case. In their own words:

> *Krygoski* is not persuasive. It effectively overrules *Torncello*, although the panel did not have this authority. The "cardinal change" test is no improvement over the "changed circumstances" test, and its basis in CICA is spurious. Finally, *Krygoski* even misapplies the "cardinal change" doctrine it invokes.

App. 20h. For the reasons set forth in the analysis, as well as those previously set forth by petitioner, this Court should grant the petition for a writ of certiorari.

Respectfully submitted,

WILSIE H. ADAMS, JR.*
PATRICK K. O'KEEFE
KURT J. HAMROCK
MCKENNA & CUNEO, L.L.P.
1900 K Street, N.W.
Washington, D.C. 20006
(202) 496-7500
Counsel for Petitioner
**Counsel of Record*

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APPENDIX

Joseph J. Petrillo & William E. Conner, *Convenience Terminations After* Krygoski, 67 Fed. Cont. Rep. (BNA) 447 (1997).

I. Introduction

One of the unique aspects of federal contracts is the government's ability to terminate a contract for its "convenience." The limits to place on this broad power have perplexed federal courts and boards of contract appeals for decades, most recently in the U.S. Court of Appeals for the Federal Circuit's decision in *Krygoski Constr. Co. Inc. v. U.S.*[1]

The plaintiff has asked the U.S. Supreme Court to review the ruling in Krygoski. If the court decides to hear the case, its opinion could change the entire legal landscape of convenience terminations. Review is not likely to be granted, however, and so contractors may have to turn to other avenues of redress.

The notion that the federal government needs extraordinary flexibility in its contractual obligations, including the ability to end them without incurring breach damages, is an old one. Although its precise origins are unclear, the termination for convenience concept appears to date to the Civil War in connection with the need to bring a quick end to wartime production.[2] It was alluded to over 150 years ago in the U.S. Supreme Court's decision in *U.S. v. Corliss Steam-Engine Co.*, which recognized the need for military departments to modify, suspend or settle contracts for armaments due to "contingencies," including the rapid pace of technological improvements.[3]

Following World War II, the termination for convenience concept was incorporated into peacetime, non-military contracts as well.[4] When the contractor was terminated for convenience, instead of receiving damages calculated upon common law breach of contract, it was lim-

ited to recovery of "costs incurred, profit on work done and the costs of preparing the termination settlement proposal. Recovery of anticipated profit [was] precluded."[5]

Termination for convenience also evolved into a mechanism to reduce government liability for breach of contract. Through the doctrine of "constructive" termination for convenience, courts and boards assumed that under certain circumstances, the government would have terminated a contract for convenience, although it did not actually do so. Thus, if a termination for default was later found improper, it was converted into one "for the convenience of the government." As a result, the government was insulated from paying breach damages in situations where a private party would have to pay them.

In 1963, the U.S. Court of Claims held that termination for convenience was a "deeply ingrained strand of public procurement policy."[6] It was considered so consequential to modern government contracts that under the "Christian doctrine," the termination for convenience clause will be read into a contract by operation of law if contracting officials omit it.[7] At about the same time, the termination for convenience clause also evolved into an exculpatory provision which insulated the government from breach damages when it wrongfully terminated a contract for default.[8] What had started as a way to ease the transition from war to peace had become, without any action by Congress, almost universal immunity from damages for breach of contract.

II. Development of Limitations on the Government's Ability to Terminate Contracts for Its Convenience

A. The Pre-*Torncello* Era

Prior to June 1982, various judicial and administrative decisions held that a contractor could successfully

prevail in challenging a termination for convenience only by demonstrating bad faith or a clear abuse of discretion on the part of government officials.[9] An argument based upon bad faith, however, carries an extremely heavy burden of proof. Federal government officials enjoy a heavy (but presumably rebuttable) presumption of acting in good faith.[10] Overcoming this presumption means that "well-nigh irrefragable proof"[11] must demonstrate otherwise. Not surprisingly, a case founded upon bad faith was (and remains) seldom successful.

There is a good deal of controversy about what is necessary to show an abuse of discretion in a contracting context. This standard is sometimes equated with a finding that a government official's actions were "arbitrary and capricious." In some cases the standard is so strictly applied that it is either the equivalent of bad faith or it means showing that there is no reasonable basis for the government's decision.[12]

The Court of Claims' opinion in *Colonial Metals Co. v. U.S.*,[13] illustrates the problems faced by contractors in the early termination for convenience cases. There, the Navy awarded a contract to Colonial Metals Co., a copper dealer operating on the secondary market, for a large, but disputed, amount of copper ingots. Colonial ordered the required amount of ingots, but one month later, the Navy terminated the contract for convenience in order to buy the copper from another supplier at a much lower price. Colonial's claim for damages failed at both the Armed Services Board of Contract Appeals ("ASBCA") and the Court of Claims. The court ruled that where "the contracting officer knew of the better price elsewhere when he awarded the contract to plaintiff—in the absence of some proof of malice or conspiracy against the plaintiff [citation omitted]—[this] means only that the contract was awarded improvidently and does not narrow the right to terminate."[14]

Thus, the doctrine of convenience termination seemed to give the government a unilateral right to back out of contracts—even retrospectively—at any time, for any reason, and without paying damages. Under these circumstances, a government contract began to look like a very different specimen from what the common law regarded as a binding agreement. The government's obligations had become so diluted, that it seemed the standard government contract might fail for lack of consideration.[15]

B. The *Torncello* Case

However, in 1982 the Court of Claims changed the landscape of convenience termination litigation. In *Torncello v. U.S.*,[16] a plurality opinion by three of the six judges held that for a termination for convenience to be valid, there must exist some change in the circumstances or in the parties' expectations after award to warrant the termination. The other three judges concurred in the result, but not in the reasoning. As we shall see, the fact that *Torncello* was a plurality, rather than a majority, opinion has contributed to the misunderstanding and misapplication of the court's ruling.

Briefly, in *Torncello* the Navy entered into a one-year, 12-item contract awarded on an "all or none" basis with Soledad Enterprises Inc. ("Soledad")[17] for grounds maintenance and refuse removal services for six Navy family housing facilities in San Diego. Although its price was advantageous for the contract as a whole, Soledad charged a very high rate for one of the twelve items, pest control services. The Navy never ordered the pest control services from Soledad, choosing to perform the work more cheaply in-house. The contract was subsequently terminated for default, and Soledad appealed the termination to the ASBCA.

1. The ASBCA Decision

Soledad argued before the Board that its contract was a requirements contract obligating the government to procure all of the services required of the type covered under the contact from Soledad. Soledad contended that by obtaining pest control services from the Navy's own Department of Public Works, the Navy had breached the contract to procure such services only from Soledad. The Board, however, found it "unnecessary" to rule on this point, and held that even if it was a requirements contract, the Navy's failure to order work under the contract did not constitute a breach because the Navy could have terminated the contract for convenience. Thus, the Navy's failure to abide by the terms of its contract with Soledad constituted a "constructive" termination for convenience.[18] Further, because Soledad's contract incorporated the Federal Acquisition Regulation's ("FAR") "short form" termination for convenience clause,[19] which expressly limited recovery to payment for services rendered only up to the time of termination—and as the Navy had not ordered pest control services from Soledad—the Board held that Soledad was not entitled to any recovery.[20]

2. The Court of Claims Decision

On appeal to the Court of Claims, the court heard the case *en banc* "because of the exceptional importance of the legal issues involved."[21] Three of the six judges held that Soledad's contract was a requirements contract, that the Navy's failure to order work under the contract was a breach, and that the Navy could not rely upon the termination for convenience clause to escape liability. Importantly, this "plurality opinion" by Judges Bennett, Kashiwa and Smith observed that if the government's power to terminate contracts for its convenience were unlimited, then contracts would be illusory for lack of consideration:

> We note as one of the elementary propositions of contract law that a party may not reserve to itself a method of unlimited exculpation without rendering its promises illusory and the contact void, and we question if the government's termination for convenience clause should be construed that broadly.[22]

The plurality found the solution to this conundrum in the history of the clause. The opinion concluded that the clause, properly invoked, was a tool to extricate the government when there was a change in circumstances subsequent to award (e.g., such as the end of hostilities in a wartime contract):

> [W]e must read the termination for convenience clause in Soledad's contract to require some kind of change from the circumstances of the bargain or in the expectations of the parties. These are just the historical limits on the clause as they have developed from *Corliss*.[23]

The court's opinion also overruled *Colonial Metals Co. v. U.S.*[24]

As noted, the three other sitting judges of the court concurred in the result, but each wrote a separate opinion. This has led to confusion and controversy, as discussed below.

C. Application of *Torncello*

For the most part, the courts and boards of contract appeals have struggled with the proper scope and application of the holding in *Torncello*, largely due to the fact that the case's forcefulness is diminished by its plurality, rather than majority, opinion, and confusion over precisely what *Torncello* teaches. As a result, two views have emerged from *Torncello* regarding convenience terminations. The broad view of *Torncello* limits the government's use of the termination for convenience clause to situations in which the circumstances surrounding the

parties' bargain at the time of contract award change unexpectedly. Under the narrow view of *Torncello*, absent bad faith or abuse of discretion, the government apparently enjoys unfettered discretion to terminate a contract for convenience, except that it may not terminate for convenience a requirements contract merely to avoid liability for breach.

According to Professor Emeritus John Cibinic, "*Torncello* has been cited for various legal propositions in 90 board of contract appeals decisions, 46 Claims Court and Court of Federal Claims decisions, and 12 Federal Circuit decisions."[25] These cases, however, mostly fall into a few categories.

1. Improper Diversion Under Requirements Contracts

Torncello involved a requirements contract. Therefore, it has stood for the proposition that when the government diverts to another contractor services to be provided under a requirements contract, there is a breach of contract, and the contractor is entitled to an award of lost profits.[26]

2. Improvidently Awarded Contracts

Another area where *Torncello* has been influential is in identifying when the government can use its convenience termination power to exit an improvidently awarded contract. In *Nationwide Roofing & Sheet Metal Co. Inc. v. U.S.*,[27] the Claims Court, relying on *Torncello*, held that the government could properly utilize the termination for convenience clause to cure a defective contract award. The Air Force planned to award a contract for roof repair and replacement to the lowest bidder. That bidder, however, had submitted its bid bond guarantee on the wrong form, and the contracting officer determined that this deficiency rendered its bid nonresponsive. He made award to the second-lowest bidder, and the

low bidder filed an agency-level protest. The Air Force sustained the protest and terminated the contract for convenience, awarding the contract to the low bidder. The terminated contractor protested to the General Accounting Office, but lost there. It then filed suit in the Claims Court, arguing that under *Torncello* the court should invalidate the convenience termination because the government "knew or should have known" that the low bid was responsive all along. The court disagreed, holding that it was consistent with *Torncello* to "utiliz[e] the termination for convenience clause to limit the government's liability and to correct an improper contract award in order to preserve the integrity of the competitive procurement process."[28]

Somewhat similarly, in 1989 the Claims Court upheld a convenience termination resulting from a court decision regarding a bid protest in *Salsbury Indus. v. U.S.*[29] In *Salsbury,* the contractor brought a breach of contract action after the Postal Service terminated the contract for convenience to comply with a district court injunction requiring it to award the contract to a previously disqualified offeror or resolicit the procurement. In sustaining the ensuing convenience termination, the *Salsbury* court explained that:

> *Torncello* only requires that the events that provoke the government's conclusion that termination is in its best interests be unexpected, *i.e.*, inconsistent with the assumption of the parties when they entered the contract. It does not require that the events also not be reasonably foreseeable to the parties.[30]

Salsbury appealed to the U.S. Court of Appeals for the Federal circuit ("CAFC" or "Federal Circuit"), which affirmed, but on broader grounds. The appellate court read *Torncello* narrowly as going no further than Chief Judge Friedman's brief concurring opinion: "*Torncello* has nothing to do with this case. It stands for the unre-

markable proposition that when the government contracts with a party knowing full well that it will not honor the contract, it cannot avoid a breach claim by adverting to the convenience termination clause."[31] This summary follows most closely the laconic concurring opinion of Chief Judge Friedman, discussed later in this analysis.

The *Salsbury* court's explanation of *Torncello* received favorable treatment in *Caldwell & Santmyer Inc. v. U.S.*[32] When errors in the low bid permitted its withdrawal, the contract went to the second low bidder, Caldwell & Santmyer. This bid, however, also had the same errors as the low bidder, i.e., the omission of certain equipment. Accordingly, the contracting officer decided to terminate the contract for convenience and resolicit the work. Caldwell & Santmyer pursued its claim for breach damages to the Federal Circuit, which ruled that "*Salsbury* teaches that bad faith . . . is a prerequisite for a *Torncello* claim."[33]

However, in *OAO Corp.*,[34] the General Services Board of Contract Appeals ("GSBCA") invalidated a termination for convenience where, following a bid protest, the government had entered into a settlement agreement with a protester to terminate the awardee's contract. The Board held that the use of the termination for convenience clause solely to avoid litigation was improper, and reinstated the original contract.

3. Convenience Termination as Damage Avoidance

Two years after the Court of Claims decided *Torncello*, the Claims Court[35] issued its opinion in *Municipal Leasing Corp. v. U.S.*.[36] There, the Air Force had entered into a "lease to ownership" contract with Municipal for computer terminals. The contract incorporated an availability of funds clause which stated that

option exercise was predicated on the availability of funds, but that the Air Force "shall use its best efforts to obtain appropriations of the necessary funds to meet its obligations and to continue this contract in force."[37]

Ultimately, the Air Force notified Municipal that it would not be exercising the second option year of the contract due to an unavailability of funds. Municipal challenged the Air Force's actions, arguing that the Air Force had not used its "best efforts" to obtain contract funding. The government contended that the Air Force had acted properly as funds were unavailable, and that the nonrenewal of the contract was proper as a constructive termination. The Claims Court determined that the Air Force had not used its best efforts to obtain contract funding, but had decided that the contract was no longer necessary—and simply did not seek funds to renew the contract for the second option year.

The court also determined that the Air Force intended to repair existing computer terminals rather than buy the Municipal terminals, an option that the Air Force had apparently considered and rejected prior to contracting with Municipal. Accordingly, the court held for Municipal, stating that "[t]he termination for convenience clause will not act as a constructive shield to protect [the government] from the consequences of its decision to follow an option considered but rejected before contracting with plaintiff."[38]

In *Maxima Corp. v. U.S.*,[39] the Environmental Protection Agency ("EPA") awarded Maxima Corp. a fixed-price, indefinite quantity contract for typing, photocopying, editing, and related services. The contract consisted of a base year and two one-year options. The amount of work ordered by EPA, however, continually fell far short of the minimum amounts specified in the contract. Prior to the end of the base year, EPA decided to replace Maxima's contract with a cost reimbursement

contract. The parties entered into an agreement whereby Maxima would perform for an additional month beyond the first year, and then enter into a new cost-plus-fixed-fee contract.

EPA, however, did not order any work under the contract after completion of the additional month. One year later, EPA informed Maxima that the contract had been constructively (and retroactively) terminated for convenience based upon EPA's failure to order the contractual minimum during the term of the first contract. On appeal, the Department of the Interior Board of Contract Appeals held that EPA was only liable for the value of services actually ordered and received.[40] Maxima appealed to the Federal Circuit.

Interestingly, on appeal the government argued that EPA's failure to order the minimum level of services was demonstrative of *Torncello's'* "changed expectations" rule warranting convenience termination.[41] The court, however, held that the termination for convenience clause could not be applied retroactively to cure the breach.

The Claims Court has similarly declined to enforce an exculpatory provision of a surplus sales contract after a material breach by the government, holding that limiting liability to a refund of the purchase price paid would permit the government to rescind the contract at will and without penalty. The court held that enforcement of the exculpatory provision in that circumstance would result in an illusory contract, and granted the contractor anticipatory profits.[42] The Court of Claims had previously reached the same conclusion under yet another surplus sales contract with an identical exculpatory provision.[43]

4. Pre-Existing Intent

Tamp Corp.[44] is the rare case in which there was sufficient evidence of the government's intent. There, the Board held that the Navy's termination for convenience

was improper because the contracting officer had abused his discretion by intending to terminate the contract at the time he entered into a contract extension. The Navy elected not to exercise its option under a contract for mess attendant services at Navy dining facilities in Hawaii, but when award of a follow-on contract was delayed, sought a one-month extension with Tamp. However, Tamp desired a three-month extension, and the parties ultimately settled on a two-month extension. Subsequently, the contracting officer awarded the follow-on contract to another vendor and terminated Tamp's contract one month into the extension. Tamp challenged the termination at the ASBCA, and the Board, citing *Torncello*, sustained Tamp's appeal. The Board held that the contracting officer's "undisclosed intention" to terminate the contract when he entered into the extension "made a mockery of his ostensibly reluctant assent to a two month, rather than a one month, extension."[45] The Board explained that:

> The opinion for the court in *Torncello* was confined to the proposition that the Government cannot employ the Termination clause to end a requirements contract solely to obtain a better price from a different source, of both of which the Government had knowledge when it entered into the contract. However . . . the Government may not use the Termination clause to terminate a contract when it had the intention of later terminating at the time it entered the contract.[46]

The evidence of intent cited by the opinion is the hearing transcript, suggesting that the contracting officer made this damaging admission in his testimony. The Board sustained Tamp's appeal and remanded the matter to the parties to negotiate a settlement.

III. The Erosion of Limitations on the Government's Power to Terminate for Convenience

A. The *Krygoski* Case

Although the *Torncello* doctrine began to unravel almost as soon as it was created, the most serious challenge to it comes from a recent decision by the Federal Circuit. This ruling appears to repudiate the *Torncello* plurality's "changed circumstances" test for an uncertain substitute.

Krygoski Construction Co. submitted the low bid ($414,696), and was awarded a contract by the U.S. Army Corps of Engineers for demolition of two buildings at an abandoned Air Force facility. Based on blueprints of the buildings and on its own survey, the Corps estimated that the buildings contained 1,600 linear feet of asbestos pipe insulation and 650 square feet of asbestos tank and duct insulation. There were contract line items, with associated prices, for removal of each.

Prior to commencing performance, Krygoski conducted its own survey of the buildings and discovered additional asbestos present in the floor tiles and roof insulation in both buildings, which had been heavily vandalized. Krygoski proposed to remove this additional asbestos at the unit price for removing the tank and duct insulation under the contract pursuant to the contract's Variation in Estimated Quantities clause. The Corps calculated that removal of the additional asbestos contained in the floor tile would cost about $320,000 at the offered unit price.

The contracting officer considered a price increase of such magnitude (33 percent of the total contract price) to be a cardinal change, and instead terminated the contract for the convenience of the government. The Corps revised its specifications to include removal and disposal

of the additional asbestos, and resolicited the contract. Krygoski did not submit the low bid in this second competition.

Krygoski filed suit in the U.S. Court of Federal Claims ("COFC"), alleging that the Corps' convenience termination was a breach of contract. The COFC, relying upon *Torncello's* changed circumstances test, held that the government had improperly terminated Krygoski's contract, or, alternatively, had abused its discretion in terminating the contract.[47] As the court observed:

> The Government, however, in maintaining its current position that the bad faith/abuse of discretion standard is still the correct legal standard, conveniently overlooks [the] series of cases that apply the *Torncello* rule. Instead, it focuses almost exclusively on the *Salsbury* case, decided in 1990, which it believes reestablishes the bad faith/abuse of discretion standard as the exclusive standard to apply in these termination for convenience cases.[48]

The court awarded Krygoski damages, including anticipatory lost profits, and the government appealed tc the Federal Circuit.

On appeal, the CAFC reversed, concluding that the trial court committed an error of law by applying *Torncello's* changed circumstances test:

> The trial court erred by invoking and relying upon the *Torncello* plurality test. The trial court improperly found no change of circumstances sufficient to justify terminating the contract for the Government's convenience. Although arguably the Government's circumstances had sufficiently changed to meet even the *Torncello* plurality standard, this court declines to reach this issue because *Torncello* applies only when the Government enters a contract with no intention of fulfilling its promises.[49]

The Federal Circuit's opinion in *Krygoski* begins with a recitation of the history and evolution of the termination for convenience clause. The CAFC next discusses *Torncello*. Declaring that "[d]espite the adequate justification to overrule *Colonial Metals* under the existing *Kalvar* ["bad faith"] test, a plurality of judges in *Torncello* proceeded to articulate in dicta a broader test for gauging the sufficiency of a convenience termination."[50]

Determining that a termination for convenience is appropriate to prevent the government from entering into a cardinal change to the contract, the CAFC held that the contracting officer did not act in bad faith or abuse his discretion in terminating and resoliciting Krygoski's contract. Thus, the Federal Circuit reversed the COFC and remanded the case.

B. Was *Krygoski* Correctly Decided?

The first thing to note about the decision in *Krygoski* is that it was issued by a panel of the Federal Circuit. As such, it cannot overrule an *en banc* decision. *Torncello*, however, was decided by the Court of Claims, the predecessor court to the Federal Circuit, in an *en banc* decision.[51] Thus, whatever *Torncello* stands for, *Krygoski* cannot overrule it. The opinion in *Krygoski* purports not to do so.

The reading of *Torncello* by the *Krygoski* court is an unusual, if not unprecedented one. The opinion seeks the meaning of this case not in the plurality opinion, but in the concurring opinion of Chief Judge Friedman. It cites approvingly his view that "when the government enters into a requirements contract, knowing that it can obtain an item the contract covers for less than the contract price and intending to do so, there cannot be a constructive termination for convenience of the government when the government follows that course."[52] None of the

other opinions, however, cite a need to show that the government must *intend* to dishonor the contract at the time it enters into it. As Professor Cibinic points out, there was no record or finding at the Board in *Torncello* to suggest any such intent.[53]

The need for a panel decision to avoid overruling an *en banc* decision such as *Torncello* may explain one of the more innovative and curious features of the *Krygoski* opinion. The lynchpin of this decision is that:

> Recent enactments . . . have underscored rules of Government contracting which render the plurality's *dicta* in *Torncello* inapplicable to the present regime of contract administration. Recent statutes fully address the concerns of the *Torncello* plurality regarding the Government's shopping for lower prices after contract award.[54]

These recent enactments and statutes are really only one—the Competition in Contracting Act ("CICA"), which became law in 1984.[55] The opinion states that by compelling the use of "full and open competition," CICA bounds when a contracting officer should and should not terminate a contract for convenience.[56]

This logic runs as follows. The emphasis of CICA on competition compels a contracting officer to ensure that the government's requirements are properly advertised, and to make efforts to obtain an adequate number of competitors.[57] Termination for convenience permits a second chance when the contracting officer determines that an awarded contract did not result from an adequately competitive process.

But the *Krygoski* court also recognizes the need for additional limits. Termination for convenience to permit a new competition is not justified simply because of the contracting officer's whim, or a change of heart. As the opinion puts it, "[n]ot every necessary alteration of the

contract scope, however, requires a new bid procedure."[58] The test adopted by *Krygoski* is a familiar one—the "cardinal change" doctrine. When the government's needs can only be met by a cardinal change in the contract, then termination for convenience is justified, indeed required, to permit a new contract competition.

This new test deserves to be examined in detail. The first striking feature is its novelty. There have been numerous decisions on the *Torncello* issue since the enactment of CICA in 1984, including several at the Federal Circuit, but none of them made this connection until *Krygoski*.

The second odd feature of Krygoski is its bald assertion that "[i]n 1984, CICA articulated significant factors addressing a contracting officer's decision to terminate a contract for the government's convenience."[59] Indeed, neither the phrase "termination for convenience," nor the concept of a unilateral right to walk away from an agreement at minimal cost, appears anywhere in CICA. The idea of a connection between convenience termination and the requirement for competition is, so far as can be determined, entirely an innovation of the *Krygoski* opinion.

But the most interesting aspect of *Krygoski* is its notion that CICA altered the legal landscape in a way that gave new meaning to the government's authority to terminate for convenience. This idea permits the opinion to sidestep the troublesome problem of whether it is overruling the *en banc* opinion in *Torncello*. However, the legal innovations which *Krygoski* attributes to CICA are not really new at all. Without exception, CICA simply did not alter the law in the ways the opinion suggests.

According to the opinion, the major new feature of CICA with implication for convenience terminations is the requirement for "full and open competition."[60]

However, the pre-CICA regulations, which had the force and effect of law, already required "maximum practicable competition."[61] Although the CICA standard seems more absolute, in practice there is no meaningful distinction between these two formulations.[62] Both are strong pro-competitive standards.

The next feature of CICA raised by the opinion is that it led to regulations which "may compel a new bid" if "a contracting officer discovers that the bid specifications inadequately describe the contract work."[63] Again, however, the post-CICA regulations are indistinguishable from what went before. The test for cancellation of a solicitation and reopening the competition in the post-CICA regulations is a mere rephrasing of the standard which already existed.[64]

The conclusion of the court's analysis is the assertion that, when a contract modification would be beyond the scope of the original contract competition, it requires a new bid procedure. Even this formulation goes too far.

First, the Comptroller General has said on many occasions that such a profound change is not unlawful, if it can be justified under CICA rules as a sole-source contract.[65] There are certainly situations where legitimate considerations of urgency might justify a bilateral modification under the procedures for noncompetitive contracting, even if it is outside the scope of the contract competition.

Second, there are also instances where the government's needs can be satisfied by the award of a second contract to cover what would otherwise be a cardinal change.[66] In both cases, termination of the original contract award would be unnecessary, and so it would not be appropriate for the government to avoid its contractual obligations.

Krygoski goes on to note that a cardinal change, by definition, is a contract modification which goes beyond the scope of the original competition. There is a close correspondence between the cardinal change doctrine and the reasonable expectations of the original bidders or offerors. Indeed, the two concepts may be identical. Krygoski stands for the proposition that termination for convenience is a legitimate escape from a situation which would otherwise develop into a cardinal change.[67]

Krygoski correctly recapitulates the law of cardinal changes. It quotes a 1993 CAFC case which summarizes the test as follows:

> [A cardinal change] occurs when the government effects an alteration in the work so drastic that it effectively requires the contractor to perform duties materially different from those originally bargained for.[68]

However, *Krygoski* applies this law in a questionable way. Removal of additional asbestos, when a significant amount was already expected, hardly seems "drastic" or "materially different." The contracting officer testified that the termination for convenience was motivated by a cardinal change resulting from the "discovery" of additional asbestos to be removed during demolition.[69] The government applied a "rule of thumb" that an increase in price of about 33 percent would constitute a cardinal change.[70] The trial court scoffed at this justification, citing case law which held that under proper circumstances, more than doubling the contract price is not itself determinative of a cardinal change.[71]

The appellate court, however, found the contracting officer's views persuasive. It was impressed that "[a]sbestos removal, originally about 10%, became about 50% of the contract work."[72] This change in proportion might have induced "different bidders, like asbestos removal firms," to enter the competition, the court specu-

lated. Since the additional asbestos removal was in the floor tile, rather than the insulation materials called out in two contract line items, the CAFC concurred that this amounted to a material departure from the scope of the original procurement.

This conclusion is a hard pill for practitioners to swallow. Construction contracts are notorious for being richly veined with changes, suspensions, differing site conditions, and other entitlements to additional compensation. It is expected, for example, that an excavating contractor which encounters an underground spring or a rock ledge will, after notice and direction, continue the work and claim the increased costs. Demolition of old, abandoned, and vandalized structures, like the ones involved in *Krygoski*, also may be reasonably expected to have unforeseen conditions and problems, and the presence of additional asbestos should have surprised no one. The contract did call out in two line items the removal of asbestos insulation, but the third line item was for "Demolition, Removal, and Disposal" of the structure itself. Why shouldn't the removal of undisclosed asbestos amount to a constructive change in "the specifications (including drawings and designs)" or "the method or manner of performance of the work," or even in "the Government-furnished . . . site," as provided for in the standard Changes clause used in defense contracts at the time?[73]

Krygoski is not persuasive. It effectively overrules *Torncello*, although the panel did not have this authority. The "cardinal change" test is no improvement over the "changed circumstances" test, and its basis in CICA is spurious. Finally, *Krygoski* even misapplies the "cardinal change" doctrine it invokes.

IV. The Future of Termination for Convenience

"There must be some way out of here,"
Said the joker to the thief,
"There's too much confusion,
I can't get no relief."

—Bob Dylan, *All Along the Watchtower*.

If the Supreme Court grants Krygoski's petition for *certiorari*,[74] the resulting opinion might clarify matters. Since the odds are against this eventuality, the contracting community needs to consider how to adjust to this latest ruling on the scope of the government's power to terminate a contract for convenience. Some routes are foreclosed. So long as the termination clause remains mandatory and (nearly) universal, there is little prospect of negotiating limits during the contract formation process on the use of convenience termination during contract performance.

A. The Continuing Need for Limits

Does *Krygoski* leave us with any meaningful limits on the government's rights to terminate for convenience ?

Apparently not. *Torncello* appears to be the first case in which a contractor actually succeeded in obtaining a ruling that a termination for convenience was (or would be) improper, and that it was entitled to breach damages against the sovereign. If the Federal Circuit now discards the "changed circumstances" test of the *Torncello* plurality, we are likely to return to the days before it was decided. There will be a theoretical limit to the government's power to terminate for convenience (bad faith or abuse of discretion), but it would be so remote, a contractor could not realistically expect to prove it had been transgressed.

For the reasons set forth above, we do not think that the answer to this conundrum is found in Chief Judge Friedman's concurrence. There seem to be two points on which a majority of the *Torncello* judges agreed (apart from the actual judgment). First, four judges—the plurality and Judge Davis—explicitly overruled *Colonial Metals*. Second, the concurring opinion of Judge Davis can be squared with the plurality opinion, if one takes into account a dispute over mere nomenclature.

The basic division between the plurality and two of the three concurring opinions is over what is and is not sufficient to constitute "bad faith" (Davis) or "abuse of discretion" (Nichols). The plurality does not define these terms as broadly as these two concurring judges, and so they express their ruling in other terms.

However, a majority of four judges espoused in some form the "changed circumstances" test, although they parted ways over whether the situation in *Torncello* amounted to bad faith. Judge Davis would hold the government liable where it terminates the contract to take advantage of a better price known before award of a requirements contract. The lack of a changed circumstance is implicit in the pre-existing knowledge, and thus is critical to the result. A major dispute between Judge Davis and the plurality opinion is over the issue of whether the government could properly terminate a contract to take advantage of a better price appearing for the first time after contract award. Judge Davis's objection to the plurality's *dictum* that this would be improper points out that "a better price appearing [after contract execution] appears to be . . . a change in conditions."[75] Thus, a faithful reading of *Torncello* finds a majority of the judges in favor of requiring *some* change in circumstances before approving a termination for convenience.

It is harder to square Judge Nichols's opinion with the others. He stresses the "all or none" aspect of the

contract, and finds it improper for the government to terminate a portion of such a contract to enjoy a better price, while retaining the benefit of the rest of the contract. The government's foreknowledge of this better price is never mentioned, and so Judge Nichols seems at odds with both the plurality and with Judge Davis's decision.

Returning to a "changed circumstances" test will not immediately answer all questions; the facts of *Torncello* do not embrace every eventuality. But it is a better starting point than the "intent" test of Chief Judge Friedman's concurrence, or the "cardinal change" standard of the *Krygoski* opinion.

The "changed circumstances" test can be revived, for example, by an *en banc* decision of the Court of Appeals for the Federal Circuit. Since contractors have little recourse save aggressive litigation, there will be opportunities for such a ruling.

Another route to meaningful limits would be through a change to the Federal Acquisition Regulation. A subcommittee of the American Bar Association Section of Public Contract Law is pursuing this prospect. However, it is questionable that the government is or will be motivated to limit its currently broad powers to stop contract performance without fear of liability for expectation damages.

B. 'Abuse of Discretion' in Default Termination: a Curious Result

A curious anomaly results from the use of the constructive termination doctrine as a damage limitation device.[76] This arises from the situation where a contractor is in technical default of a contract, but the termination of that contract for default would be an abuse of discretion. On this basis, default terminations have been reversed where they were motivated by a desire to rid the

government of dealing with the contractor,[77] or to end a troubled program.[78] When that happens, the default termination is converted to one for the convenience of the government.[79] The abuse of discretion which characterized the termination for default does not taint the government's actions sufficiently to deny it the benefits of a termination for convenience.

This can lead to a questionable result. In *Torncello,* for instance, the government breached a requirements contract by diverting the fulfillment of some of its needs to another source. Assume instead that it had terminated that portion of the contract for default. This termination would have been without cause, and presumably would have been an abuse of discretion. Under the above doctrine, however, the improper default termination would merely have become one for convenience.[80] Why should the government be better off when it improperly terminates a contract for default than when it improperly terminates a contract for convenience?

One answer might be that the government actually has a broader scope of discretion to terminate for convenience than for default, and this seems a reasonable premise. However, the case law dealing with abuse of discretion in default terminations needs to recognize this issue. After concluding that the termination for default was an abuse of discretion, the court or board then needs to consider whether a convenience termination under the same circumstances would also be improper, and therefore whether the proper remedy is damages for breach of contract.

C. Litmus Test for Commercial Practices?

Barring a reversal of *Krygoski,* there could still be legislative or regulatory action to return terminations for convenience to their original realm, i.e., contracts for weapons systems or other uniquely governmental needs. Even in this limited sphere, the issue of limits to the

power to terminate for convenience would still arise. But it would happen much less frequently, and in a context where the government's interests were more compelling.

Restricting the termination for convenience clause to only some contracts is consistent with the current trend to "commercialize" government procurement. A unilateral right to disavow obligations, without answering in money damages, is rare or unheard of in commercial contracts. To be sure, some commercial contracts include a cancellation right. But these almost always require advance notice and are either exercisable by either party or restricted to contracts where cancellation would have little or no impact on the terminated party.

The FAR now permits contracts for commercial items to be "tailored" to customary commercial market practices.[81] The FAR lists certain provisions which cannot be altered. However, the termination for convenience clause is not on this list, and so it *can* be modified for, or even excluded from, contracts for commercial items.

However, the regulations for procuring commercial items do include a "standard," but nonmandatory termination provision, which perpetuates the government's right to terminate a contract for its convenience.[82] When a commercial item contract is terminated for convenience, the contractor's recovery is limited to "a percentage of the contract price reflecting the percentage of the work performed prior to the notice of termination, plus reasonable charges the Contractor can demonstrate to the satisfaction of the Government using its standard record keeping system. . . ."[83] In other words, no anticipatory profit.

As the federal government increasingly attempts to mimic commercial practices in its procurement operations, it will be interesting to see whether it is willing to shed advantageous, government-specific features like termination for convenience. Whether the contract con-

tains such a clause may be a simple but effective test for whether a contract is truly "commercial."

Endnotes

1 No. 214-89C (Fed. Cl. March 2, 1993, 1993 WL 840295 (Fed. Cl.), *rev'd*, 94 F.3d 1537 (Fed. Cir. 1996), *petition for cert. filed*, No. 96-1236 (Feb. 5, 1997).

2 *Torncello v. U.S.*, 618 F.2d 756, 764 (Ct. Cl. 1982).

3 91 U.S. 321 (1876). The court's opinion mentions "the improvements constantly made in ship-building and steam machinery and in arms . . . ." 91 U.S. at 323.

4 2 *Nash & Cibinic, Federal Procurement Law* 1107 (3d ed. 1980).

5 *Id.* at 1104.

6 *G.L. Christian & Assocs. v. U.S.*, 312 F.2d 418, 426 (Ct. Cl.), *reh'g denied*, 320 F.2d 345, *cert. denied*, 375 U.S. 954 (1963).

7 *See General Eng'g & Mach. Works v. O'Keefe*, 991 F.2d 775 (Fed. Cir. 1993); *G.L. Christian & Assocs. v. U.S.*, *supra*.

8 *2 Nash & Cibinic, Federal Procurement Law*, *supra*, at 1121-26.

9 *See, e.g., John Reiner & Co. v. U.S.*, 325 F.2d 438, 442 (Ct. Cl. 1963) ("[I]n absence of bad faith or a clear abuse of discretion the Contracting Officer's election to terminate is conclusive."), *cert. denied*, 377 U.S. 931 (1964).

10 *See, e.g., Sanders v. U.S. Postal Serv.*, 801 F.2d 1328, 1331 (Fed. Cir. 1986).

11 *Kalvar Corp. v. U.S.*, 211 Ct. Cl. 192, 198 (1976), *cert. denied*, 434 U.S. 830 (1977).

12 *See U.S. Fidelity & Guar. Co. v. U.S.*, 230 Ct. Cl. 355, 369 (1982).

13 494 F.2d 1355 (Ct. Cl. 1974).

14 *Id.* at 1361.

15 Consideration is, of course, an essential element of a valid, enforceable government contract. *See Simpson v. U.S.*, 172 U.S. 372 (1899); *Willard, Sutherland & Co. v. U.S.*, 262 U.S. 489 (1923).

16 681 F.2d 756 (Ct. Cl. 1982) (*en banc*).

17 Ronald A. Torncello was the president and later trustee in bankruptcy of Soledad Enterprises Inc.

18 Constructive termination for convenience is a judicial doctrine that may be invoked to excuse the government's action to terminate a contract when the basis upon which a contract was terminated was legally inadequate to justify the government's termination. This doctrine evolved from *College Point Boat Corp. v. U.S.*, 267 U.S. 12 (1925), in which the Supreme Court held that actions by a contracting party may be supported at a later date by any reason that could have been advanced at the time of the actions, even though the party was not then aware of it.

19 The short form termination for convenience clause in *Soledad* is essentially the same as FAR 52.249-4 (Termination for Convenience of the Government (Services)) (Short Form).

20 *See Soledad Enters. Inc.*, ASBCA Nos. 20424 *et al.*, 77-2 BCA ¶ 12,552. Under the FAR's standard (long form) termination for convenience clause, FAR 52.249-2, Soledad likely would have recovered the usual termination costs.

21 *Torncello*, 681 F.2d at 773.

22 *Id.* at 760. The idea that an unlimited power to terminate for convenience would undermine the enforceability of a contract seems to derive from Professors Nash and Cibinic. *See* 2 *Nash & Cibinic, Federal Procurement Law, supra*, 1115 n. 5.

23 *Id.*

24 *Id.*

25 10 Nash & Cibinic Report ¶ 52 (Oct. 1996).

26 *See, e.g., S & W Tire Servs., Inc.*, GSBCA No. 6376, 82-2 BCA ¶ 16,048.

27 14 Cl. Ct. 733 (1988).

[28] *Id.* at 736.

[29] 17 Cl. Ct. 47 (1989), *aff'd*, 905 F.2d 1518 (Fed. Cir. 1990), *cert. denied*, 498 U.S. 1024 (1991).

[30] 17 Cl. Ct. at 58. *See also Biener GmbH v. U.S.*, 17 Cl. Ct. 802 (1989) (changed circumstances rule not applicable in absence of short form termination for convenience clause and knowledge at time of contracting that work could be obtained from another source at cheaper price.)

[31] 905 F.2d at 1521.

[32] 55 F.3d 1578 (Fed. Cir. 1995).

[33] *Id.* at 1582.

[34] GSBCA No. 10186-P, 90-1 BCA ¶ 22,332.

[35] Effective Oct. 1, 1982, the U.S. Court of Claims was abolished and was replaced by the U.S. Court of Appeals for the Federal Circuit and a new U.S. Claims Court. Federal Courts Improvement Act of 1982, PL 97-164, §§101, 171-77, 96 Stat. 25, 27-28 (1982). The Claims Court was renamed the U.S. Court of Federal Claims effective October 29, 1992. Federal Courts Administration Act of 1992, PL 102-572, Title IX, §902(b), 106 Stat. 4506, 4516 (1992).

[36] 7 Cl. Ct. 43 (1984).

[37] *Id.* at 45.

[38] *Id.* at 47.

[39] 847 F.2d 1549 (Fed. Cir. 1988).

[40] IBCA No. 1828, 86-2 BCA ¶ 18,888.

[41] 847 F.2d at 1555.

[42] *Stoner-Caroga Corp. v. U.S.*, 3 Cl. Ct. 92, 96 (1983).

[43] *Peck Iron & Metal Co. v. U.S.*, 603 F.2d 171, 172-73 (Ct. Cl. 1979).

[44] ASBCA No. 25692, 84-2 BCA ¶ 17,460.

[45] *Id.* at 86,977.

46 *Id.*

47 *Krygoski Constr. Co. Inc. v. U.S.*, No. 214-89C (Fed. Cl. March 2, 1993), 1993 WL 840295 (Fed. Cl.).

48 *Id.* at 9.

49 *Krygoski Constr. Co. Inc. v. U.S.*, 94 F.3d 1537, 1545 (Fed. Cir. 1996).

50 *Id.*

51 *See South Corp. v. U.S.*, 690 F.2d 1368, 1370 n.2 (Fed. Cir. 1982) (Court of Claims decisions are binding precedent unless and until overruled by the Federal Circuit sitting *en banc*).

52 681 F.2d at 773. This statement was also cited approvingly in *Salsbury* and *Caldwell & Santmyer*.

53 10 Nash & Cibinic Report ¶ 52 (Oct. 1996).

54 94 F.3d at 1542.

55 PL 98-369, 98 Stat. 1175 (1984), codified as amended at 10 USC §§2304 *et seq.*; 41 USC §§251 *et seq*. Actually, CICA was only two years old when Krygoski's contract was terminated for convenience.

56 94 F.3d at 1542-43.

57 More modern thinking, however, posits that this emphasis on competition is outmoded and inefficient, and that the wisdom and judgment of government officials adequately protects the taxpayer's interests.

58 94 F.3d at 1543.

59 *Id.* at 1542.

60 The opinion cites in this regard 41 USC §253(a)(1)(A), 401, 405(a) & 416 and 10 USC §2304.

61 Defense Acquisition Regulations 1-300.1, 32 C.F.R. § 1-300.1 (1983); Federal Procurement Regulations 1-1.301-1, 41 C.F.R. § 1-1.301-1 (1983).

62 For instance, DAR 1-1.1001 required that proposed procurements be publicized "to increase competition." However, a standard of competition to the "maximum practicable extent"

has been held to justify restricting the number of offerors solicited for small purchases. *See S.C. Servs. Inc.*, B-221012, March 18, 1986, 86-1 CPD ¶ 266.

63 94 F.3d at 1543.

64 *Compare* FAR 15.606 *with* DAR 3-805.4 and FPR 1-3.805-1(a) (negotiated procurements); *compare* FAR 14.209 *with* DAR 2-209 and FPR 1-2.208 (advertised procurements).

65 *See, e.g., Corbin Superior Composites Inc.*, B-234019; B-235019.2, July 20, 1989, 89-2 CPD ¶ 67; *Indian & Native Am. Employment & Training Coalition*, B-216421, April 16, 1985, 85-1 CPD ¶ 432; *W.H. Mullins*, B-207200, Feb. 16, 1983, 83-1 CPD ¶ 158.

66 *Cf. Hunkin Conkey Constr. Co. v. U.S.*, 461 F.2d 1270 (Ct. Cl. 1972).

67 However, in *International Electronics Corp. v. U.S.*, 646 F.2d 496 (Ct. Cl. 1981); *appeal after remand*, 2 Cl. Ct. 570, *aff'd*, 727 F.2d 1120 (Fed. Cir. 1983), the court stated that conversion of the termination from default to convenience made it unnecessary to consider whether the government's failure to provide certain promised equipment for contract performance amounted to a cardinal change.

68 *AT&T Communications Inc. v. WilTel Inc.*, 1 F.3d 1201, 1205 (Fed. Cir. 1993).

69 *Krygoski*, slip. op. at 20.

70 *Id.* at 19.

71 *General Dynamics Corp. v. U.S.*, 585 F.2d 457, 466 (Ct. Cl. 1978); *see also Reliance Ins. Co. v. U.S.*, 931 F.2d 863 (Fed. Cir. 1991) (over 200 change orders do not amount, cumulatively, to a cardinal change).

72 94 F.3d at 1544.

73 CHANGES (1968 FEB), DAR 7-602.3(a), 32 C.F.R. § 7-602.3(a) (1983).

74 *See Federal Contracts Report*, Vol. 67, No. 8, Feb. 24, 1997, pp. 221-22.

75 681 F.2d at 684.

76 We are indebted to Alan V. Washburn Esq. for bringing this anomaly to our attention.

77 *Darwin Constr. Co., Inc. v. U.S.*, 811 F.2d 593 (Fed. Cir. 1987).

78 *McDonnell Douglas Corp. v. U.S.*, 35 Fed. Cl. 358 (1996).

79 *Darwin Constr. Co., Inc.*, 811 F.2d at 594; *McDonnell Douglas Corp.*, 35 Fed. Cl. at 369.

80 Since Soledad's contract contained a short form termination for convenience clause, it was entitled to no recovery at all. *Torncello*, 681 F.2d at 759-60.

81 FAR 12.302.

82 FAR 52.212-4.

83 FAR 12.403(d); FAR 52.212-4(1).